

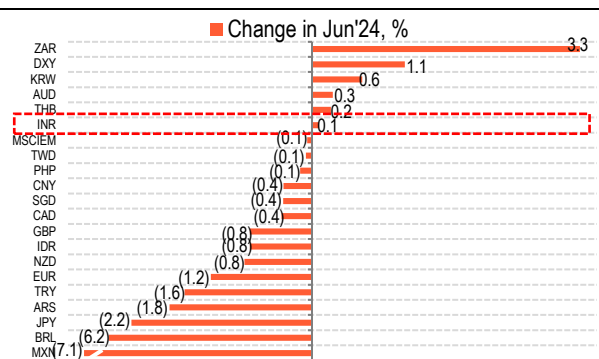
Currency update

INR appreciated marginally in Jun'24, after touching a fresh record-low during the month. In H1 2024, INR has depreciated by 0.2%, even as the dollar strengthened by over 4.5%. RBI's effective management as well as India's strong macro fundamentals have underlined the strength in the domestic currency. The trajectory of INR will be determined by the movement in dollar. While US inflation and growth is showing signs of a moderation, the possibility of monetary easing will face hurdles due to the evolving political landscape in the country. As of now, a rate cut is priced in for Sep'24, however, the path forward will be contingent on the election results in Nov'24. Till then, we can expect some volatility in the global markets and DXY. This will also have an impact on INR. On the positive side, domestic conditions have remained more or less the same for INR and suggest an appreciating bias for the currency. We expect INR to trade in the range of 83.25-83.75/\$.

Movement in global currencies in Jun'24

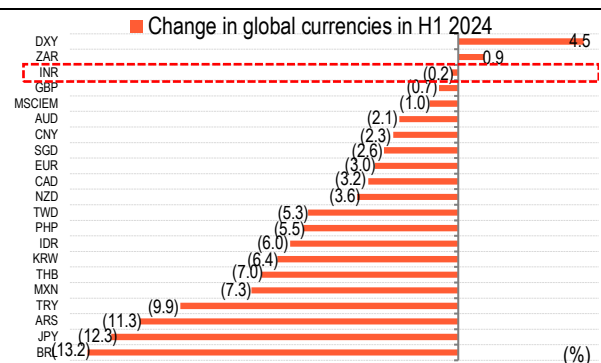
Global currencies mostly depreciated against the dollar. DXY rose by 1.1% higher as investors assessed macro data. Inflation in the US as measured by the core PCE index moderated. Growth indicators pointed a slowing momentum with a further decline in manufacturing PMI. While the data reinforces view of a Sep'24 rate cut, FOMC officials have continued to downplay the much-awaited pivot in the Fed's rate path. Fed's latest projections suggest the likelihood of a single rate cut in 2024 compared with expectations of 3 rate cuts at the start of the year. Political uncertainty also played a part after the first US presidential debate. Even in the UK and France, political uncertainty weighed on investor sentiments. On the other hand, JPY depreciated to a 38-year low as policy divergence with the US is expected to continue in the near-term. Rising US treasury yields also exacerbated the interest rate differential between the two nations. In China, macro data continued to point towards an uneven recovery, which also weighed on its treasury yields and interest rate differential.

Figure 1: Global currencies in Jun'24



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Jun 2024 | Figures in brackets indicate depreciation against the dollar

Figure 2: Global currencies in H1 2024



Source: Bloomberg, Bank of Baroda Research | Note: Data as of 29 Jun 2024 | Figures in brackets indicate depreciation against the dollar

Performance of rupee

INR appreciated by 0.1% in Jun'24 even as it touched a record-low of 83.65/\$ during the month. Stable oil prices and resumption in FPI inflows towards the latter part of the month supported the INR, even as DXY rose. The trading range for the month was 83.15-83.65/\$ or 50bps which higher than 43bps last month. The average daily annualized volatility in INR also increased to 2.9% in Jun'24 after remaining at a historical low in the last few months. This can be attributed to uncertainty during the election period and the subsequent results. In H1 2024, INR has depreciated by 0.2%. This is notwithstanding a 4.5% increase in DXY. India's stable macro fundamentals, underlined by moderating inflation, comfortable trade and fiscal deficit and buoyant growth have contributed to the rupee's over performance vis-à-vis its EM counterparts.

Outlook

INR is likely to show an appreciating bias in the next fortnight aided by both external as well as internal factors. Moderation in core PCE in the US along with weakening inflation expectations will weigh on the dollar, which is positive for INR. However, there are some risks. While we do expect USD to ease in the near-term based on the evolving macro environment picture, there are idiosyncratic factors at play due to the changing political landscape in the US. The first US presidential debate gave a little edge to the Republican candidate Donald Trump. It is widely believed that a win for Mr. Trump could possibly unhinge the progress on inflation due to policies such as tariff hikes and higher fiscal spending. With US elections scheduled for Nov'24, there is likely to be considerable volatility in the markets as markets price in this possibility. So far, this has been manifested in a sharp sell-off in US 10Y treasury yield which has risen by 17bps since the debate. A continued rally in US yields could push DXY higher and weigh on the rupee. However, RBI's strong forex buffer of over US\$ 650bn should help keep the rupee range-bound in case of this eventuality.

FPI inflows are crucial for financing the current account deficit and are hence important for external stability and the exchange rate. At US\$ 2bn, FPI inflows into India have been relatively muted so far in FY25 (data upto 1 Jul 2024). A large part of INR's strength in FY25 was based on the premise of buoyant FPI inflows as equity inflows were widely expected to be supplemented by robust debt inflows. There were several conjectures about the quantum of FPI inflows due to India's inclusion in the JP Morgan bond index which officially came into effect from 28 June 2024, with investors estimating possible inflows of ~US\$ 1-2bn on the day itself. However, the actual inflows have underwhelmed.

Based on data from NSDL, during 28 Jun to 1 Jul 2024, debt inflows into India were less than US\$ 400mn. Debt utilisation by FPIs for FAR holdings also remained largely unchanged. This can perhaps be due to the fact that a large part of frontloading by FPIs had already taken place in the period after the announcement of India's inclusion in the index in Sep'23. This can be gauged from the fact that FPI utilisation rate for some index eligible securities has increased significantly to over 10% from about 2%-4% before the announcement was made. If we do not see a meaningful pickup in FPI inflows in the coming months, there can be some pressure on INR especially if the dollar rally resumes. However, since the FPI utilisation rate still remains low we can expect further pickup in debt inflows in the coming months as India's weight in the index increases. It will also be supplemented by inflows on account of the Bloomberg bond index which is scheduled to begin from Jan'25. Also, CAD is estimated to remain in a comfortable range of 1-1.5% of GDP, which is likely to be adequately financed by foreign inflows on account of FDI and ECBs and will hence not have a sizeable impact on INR.

A greater risk for INR however comes from the depreciation in CNY. Given the strong correlation between the two currencies, a sustained depreciation in CNY can also weigh on INR, particularly since the RBI might allow for the domestic currency to depreciate to preserve the country's export competitiveness.

Overall, we expect INR to trade in the range of 83.25-83.75/\$ in the next month.

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